

## **California Division of Workers' Compensation 2006 Audit Program Description**

### **Changes to the Audit Program beginning 2003**

Assembly Bill 749, enacted into law in 2002 under Labor Code Sections 129 and 129.5, includes major changes to the Division or Workers' Compensation audit program. These changes include the following:

- The Audit Unit will be required to conduct a profile audit review (PAR audit) of each adjusting location of California workers' compensation claims at least once every five years.
- The Administrative Director will annually publish a profile audit review performance standard and a full compliance audit performance standard.
- Audit subjects that meet or exceed profile audit review performance standards will be required to pay all compensation found unpaid by the Audit Unit, but no penalties will be assessed.
- Audit subjects that do not meet or exceed profile audit review performance standards will be subject to a full compliance audit.
- Audit subjects that meet or exceed full compliance audit performance standards will be required to pay all compensation found unpaid by the Audit Unit, and will be assessed penalties for unpaid and late paid compensation only.
- Audit subjects that do not meet or exceed full compliance audit performance standards will be required to pay any compensation found unpaid by the Audit Unit, and will be assessed penalties for all violations included in a full compliance audit failure penalty schedule.
- A new factor in determining penalty amounts (for audit subjects that fail to meet or exceed the full compliance audit performance standard) will be the size of the adjusting location. Penalties assessed pursuant to the full compliance audit failure penalty schedule may be as high as \$40,000 each for the most serious violations at the largest adjusting locations. The previous maximum penalty amount was \$5,000.
- The Administrative Director shall publish and make available to the public on request a list ranking all insurers, self-insured employers, and third-party administrators audited according to their performance ratings.

### **Selection of PAR Audit Subjects**

In order to implement the changes mandated by AB 749, audit regulations have been revised extensively. Pursuant to Title 8, California Code of Regulations (8CCR), Section 10100.2, effective January 1, 2003, separate underwriting companies, self-administered, self-insured employers, and/or third-party administrators operating at one location will be combined as one audit subject for the purposes of PAR audits conducted pursuant to Labor Code Section 129(a), but only if claims are administered under the same management at that location. Where claims are administered from an office that includes a satellite office at another location, claims administered at the satellite office(s) will be considered as part of the single adjusting location for auditing purposes when demonstrated that the claims are under the same immediate management.

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The number of adjusting locations is constantly changing as a result of administrators opening, closing, and consolidating offices. For the past several years the total number of adjusting locations of California workers' compensation claims has averaged approximately 500. The Audit Unit's intent is to select most audits to be conducted from locations that have not been audited since before 2000. However, audit subjects that merit targeted audit selection based on criteria listed below also may be selected for audit.

### **Targeted Audit Subject Selection**

The Audit Unit also may target administrators for audit based on:

- Complaints regarding claims handling received by the Division of Workers' Compensation.
- Failure to meet or exceed Full Compliance Audit Performance Standards.
- High Numbers of Penalties awarded pursuant to Labor Code Section 5814.
- Information received from the Workers' Compensation Information System.

Regulations related to the targeting of audit subjects are in 8CCR§10106.1(c), effective January 1, 2003.

### **Notices of Audit and Audit Commencement**

The Audit Unit usually issues Notices of Audit far in advance of the actual audits, a procedure that allows for flexibility in planning. A Notice of Audit informs the administrator that it has been selected for audit and requests that copies of claim logs be sent to the Audit Unit, but it does not indicate when the audit will be conducted or which claims will be selected for audit. The audit may not be scheduled for several weeks, or even months, after the Notice of Audit is received. Only after the audit has been scheduled is the administrator issued a Notice of Audit Commencement. This notice, issued two to three weeks before the audit is to begin, identifies the claims that are selected for audit and includes instructions for preparing the claims for audit.

### **Selection of Claims for Audit and Performance Standards**

- **Profile Audit Review**

Beginning in 2003, indemnity claims will be randomly selected for PAR audits from the indemnity claim populations reported on the claim logs for the three years preceding the audit, as opposed to the two years preceding the audit as was the case before 2003. For audits conducted in 2006, claims will be selected from the claim logs for the years 2003 through 2005. Another change beginning with audits conducted in 2003 is that indemnity claims randomly selected for audit will be taken from the population of claims in which indemnity has been paid, not from the population of claims in which indemnity *may* be payable. The Audit Unit utilizes a table based on an expected frequency rate of

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10% with a confidence level of 90%, give or take 5%, to select the indemnity claims for the PAR audit. The table is in 8CCR§10107.1(c)(1).

If the Audit subject fails to meet or exceed the profile audit review performance standard, the sample of indemnity claims will be expanded and a full compliance audit will be conducted. The profile audit review performance standard is based on key performance factors including the payment of all indemnity due, the timeliness of payments and/or first notices involving salary continuation in lieu of temporary disability, the timely issuance of notices of potential eligibility for vocational rehabilitation, and the timely issuance of QME notices. The formula for the calculation of each year's performance standard is in 8CCR§10107.1(c)(3). The profile audit review performance standard for 2006 is **1.83856**. If the audit subject's profile audit review performance rating is 1.83856 or lower, the audit subject will be required to pay any unpaid compensation, but no penalties will be assessed. A PAR performance rating of higher than 1.83856 will result in a full compliance audit.

- **Full Compliance Audits - Audits that meet or exceed the Full Compliance Audit Performance Standard**

If a full compliance audit is conducted, the total number of indemnity claims randomly selected for audit will be based on the table in 8CCR§10107.1(d)(1). The number of claims in this full sample of indemnity claims is determined from a table utilizing an expected frequency rate of 10% with a confidence level of 95%, give or take 5%. The formula for the calculation of each year's full compliance audit performance standard is the same as for the PAR performance standard, but is based on audit results from the full sample of indemnity claims. The full compliance audit performance standard for 2006 is **2.51920**. If the audit subject's full compliance audit performance rating is 2.51920 or lower, the audit subject will be required to pay any unpaid compensation, and penalties will be assessed, but only for violations involving the failure to pay indemnity or late paid indemnity.

- **Full Compliance Audits - Audits that fail to meet or exceed the Full Compliance Audit Performance Standard**

If, after the review of the expanded sample of indemnity claims, the audit subject's performance rating is higher than 2.51920, the audit subject has failed to meet or exceed the full compliance audit performance standard, and an additional sample of denied claims will be audited. The number of denied claims randomly selected for audit is based on a table utilizing an expected frequency rate of 1% with a confidence level of 90%, give or take 3%. That table is set forth in 8CCR§10107.1(e)(1).

Following the review of all audited claims, penalties will be assessed for *all* violations. In addition, the Audit Unit will return for a target audit within two years.

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### **Audit Procedures**

Audits vary in size based on the populations of claims at the audited claims administrator adjusting locations. It is expected that one or two auditors can conduct routine PAR audits in one or two weeks. However, some may exceed this time frame. Audit subjects that fail to meet or exceed performance audit review performance standards or full compliance audit performance standards will take longer to conduct than PAR audits and may involve higher numbers of auditors.

A lead auditor who is responsible for coordination of the audit and the completion of the audit report is assigned for each audit. During the course of the audit, the auditors complete worksheets for each audited claim. The worksheets list relevant information, such as identifying data, due dates for various required actions, the bases for those actions and due dates, and amounts payable per specific periods per type of benefit. The auditors copy documents from the claim files to support the bases for any compensation due or proposed penalties. They also provide the claims administrator with copies of proposed notices involving compensation due or possible penalties at daily or other agreed upon intervals, so that the administrator may research the issues and determine whether it agrees with or disputes the findings (the idea is to get it right).

### **Preliminary Report and Post-Audit Conference**

Once the audit is completed, the lead auditor conducts a short exit interview and returns to the audit office to complete a preliminary audit report that includes a Notice of Proposed Penalty Assessments and Notices of Intention to Issue Notices of Compensation Due. After an assigned Senior Compliance Officer and/or the Supervising Compliance Officer reviews the report, the preliminary report and enclosures are issued to the claims administrator. Depending on the schedules of the participants, a post-audit conference is scheduled anytime after approximately two weeks. Periods between the receipt of the preliminary report and the post-audit conference usually do not exceed a few weeks unless it is at the request of the claims administrator.

The post-audit conference is usually held at the audit subject's adjusting location and is attended by the assigned lead and Senior Compliance Officers, the Supervising Compliance Officer, and/or whomever the claims administrator wishes to attend (claims manager, supervisors, corporate officers, legal counsel, et al). The post-audit conference may be waived if the administrator wishes. The claims administrator is encouraged to notify the Audit Unit in advance and in writing of any disputed penalty assessments and/or mitigating circumstances, and can then present any arguments and discuss any issues on an informal basis at the post-audit conference.

If the audit subject's profile audit review performance rating meets or exceeds the PAR performance standard, however, the audit subject may choose to waive the preliminary report. In

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those audits, the final audit report and any Notices of Compensation Due may be issued within one to two weeks after the completion of the audit, and no penalties will be assessed.

### **Final Audit Report, Payment of Penalties and Compensation Due, and Appeal of Penalties and/or Compensation Due**

The lead auditor prepares and issues to the audit subject by certified mail the final audit report, Notice of Penalty Assessments, and any Notices of Compensation Due. Although the goal is to issue the final report within two weeks of the post-audit conference, the process occasionally takes longer. Delays can occur if follow-up information from the claims administrator is needed or because of other audits or assignments. Copies of any Notices of Compensation Due are also issued to the appropriate injured workers. Unless appealed, penalties must be paid within 15 days of receipt of the Notice of Penalty Assessments. If some but not all penalties are appealed, those penalties that are not appealed must still be paid within 15 days of receipt of the report. Compensation due to injured workers must be paid within 15 days of receipt of the Notice of Compensation Due unless appealed within that time to the appropriate Workers' Compensation Appeals Board pursuant to 8CCR§§10110 and 10115.1

The audit subject is required to submit to the Audit Unit within 30 days documentation to indicate compliance with claims handling regulations. Documentation of compliance can include items such as copies of benefit notices, wage statements, and checks issued to injured workers and/or medical providers. Additional penalties may be assessed if the audit subject fails to submit documentation of compliance as required.

The audit subject may appeal disputed penalties to the Administrative Director within 7 days of receipt of the Notice of Penalty Assessments by requesting an appeal conference or a written decision on the appeal without a conference. If there is an appeal, within 21 days of filing the request for appeal the appellant must file with the Administrative Director a statement specifying the penalties appealed and the basis for contesting each penalty, and submit any documentation relevant to the appeal.

The Administrative Director is required to issue a Notice of Findings within 15 days of the date the appeal is submitted for review following a conference or within 15 days after receipt of the Audit Unit's written answer if no appeals conference is held. Any subsequent appeal must be made by filing a petition for Writ of Mandate to the appropriate Superior Court.

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### What to Expect - Some Things You Should Know

- Depending upon your geographic location, auditors may travel significant distances to and from the audit. When auditors have long commutes, it is not possible for them to spend the entire workday at the audit site.
- When possible, auditors may ask if you can accommodate an alternate work schedule, such as ten hours per day - four days per week, or four days at the audit site and one day entering audit data off site each week. Such a schedule allows the audit subject to have at least one day a week without auditors in your office, reduces travel expenses for the Audit Unit, and alleviates hardship for the auditors. We appreciate any accommodation you can make.
- Because of medical or dental appointments, vacations, assignments related to other audits or projects, or other unforeseen events, auditors may have irregular attendance during the audit. Even so, we will try to keep you informed as we go. Don't be concerned about changes in personnel assigned to the audit.

### How to Help the Audit Run Smoothly

- Auditors often ask questions about claims procedures or ask for additional documentation on the claims being audited. Please respond as soon as possible, since potential penalties often can be eliminated, or at least properly addressed, once the questions are answered. Audits run much more smoothly if we communicate well.
- If you have any questions about proposed penalties or compensation found due, please bring them up with the lead auditor or Senior Compliance Officer as soon as possible *during the audit*. Auditors should explain clearly the reasons for proposed penalty assessments, including instances where unpaid compensation is payable to injured workers, and support conclusions with evidence from your files and by citing the applicable statutes and/or regulations. To hold off on questions or postpone raising disputed issues until the post-audit conference causes delays and often extends the audit process substantially.
- If you have any complaints or concerns about how the audit is conducted, feel free to contact the Audit Supervisor or Audit Unit Manager. We assure you that your comments, positive or negative, will have no bearing on the way penalties are assessed or on your possible future selection for audit.